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FILED
AUG 9 1943
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 248

GENERAL MANAGEMENT CORPORATION,
A CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

CARL MEYER,
HARRY THOM,
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Chicago, Illinois,
August, 1943.

THE BUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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COMMISSIONER OF INTERNAL REVENUE,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

General Management Corporation, by Carl Meyer, Harry Thom and Benjamin A. Ragir, its attorneys, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit entered in the above cause on May 24, 1943, affirming the decision of the United States Board of Tax Appeals (now The Tax Court of the United States).

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 129) is reported in 46 B. T. A. 738. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 158) is reported in 135 F. (2d) Advance Sheet No. 6, page 882.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 24, 1943 (R. 163). The Petition for Rehearing was filed within the time prescribed by the rules of the Court (R. 163) and was denied on July 6, 1943 (R. 173). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the act of February 13, 1925 (43 Stat. 936, 28 U. S. C. A. Sec. 347(a)).

Question Presented.

Petitioner, under a contract grossing $24,000.00 during the taxable year, rendered extensive accounting and budgetary services requiring an expenditure of $16,000.00 and also provided its president to act as comptroller for the other contracting party. Were the accounting and budgetary services merely incidental to the comptroller's services so as to qualify the contract as a personal service contract defined in Section 403(e) of the Revenue Act of 1938?

Statutes and Regulations Involved.

The statutes and regulations involved will be found in the Appendix *infra* pp. 9-12.

Statement.

The pertinent facts in this case as found by the Board of Tax Appeals (R. 129) are as follows:

Petitioner, a corporation, was organized for the purpose of rendering budgetary and accounting services and general corporate financial planning services. During 1938, the year in question, of 200 shares of issued and outstanding capital stock of petitioner, 100 were owned by Grant Gillam, 80 were owned by S. Margaret Gillam, Gillam's sister, and 20 were owned by Marguerite Miller.

Gillam had wide experience in corporate management and production and through his contacts petitioner obtained business for which it was organized. During 1938 petitioner had two contracts under which it performed budgetary and accounting services and general management services. One of those contracts was with Magill-Weinsheimer Co. and the Board of Tax Appeals held that said contract was not a personal service contract, contrary to the contention of the respondent. Since no appeal was perfected by the respondent that contract is not now before the Court. The other contract, the one here in issue, was entered into by petitioner with United Printers and Publishers, Inc. (herein referred to as the "United contract") on February 11, 1937. Under the terms of the United contract petitioner for a consideration of $2,000.00 per month was required

> "To furnish from data supplied to it by the Corporation or its various divisions, monthly and annual statements, make up yearly budgets projecting the Corporation's operations, use its best efforts to negotiate such loans, as the Corporation may from time to time require in the regular conduct of its business, check all requisitions and study in detail the Corporation's various operating, management and sales problems, and submit such suggestions as it may have for reducing operating cost and improving the Corporation's profit and financial position."

The United contract, after first stating that the $2,000.00 per month payment shall cover all services required of petitioner, "including the services of said Grant Gillam as comptroller", provided that Grant Gillam shall continue to act as comptroller of United and that—

> "In the event that the said Grant Gillam shall die or shall become incapacitated to such extent as to make it impossible for him to continue as Comptroller of the Corporation and the Company is within three months thereafter unable to supply an individual for

Comptroller who is acceptable to the Corporation, this agreement may, at the option of the Corporation, be terminated."

During 1938 petitioner rendered extensive budgetary and accounting services under the United contract, including the preparation and maintenance of a detailed budget projection, preparation of budget summaries, monthly, quarterly and annual reports, income tax returns and other miscellaneous tax returns and reports. No other audits or reports were prepared by any other accountants and petitioner's audit reports were accepted by bank creditors of United.

Grant Gillam acted as comptroller of United during 1938 but since he was not an accountant and had no accounting experience he did not participate in nor spend any of his time in the rendition of the budgetary or accounting services as an employee of petitioner. Those services were performed by other employees of petitioner, seven in all. The cost to petitioner of rendering those services, in salaries and overhead, was estimated, without dispute or contradiction, to be $16,000.00.

Gillam received a salary from petitioner of $25,000.00 during the year 1938.

The Board of Tax Appeals held (R. 140) the United contract to be a personal service contract under Section 403(e) of the Revenue Act of 1938 on the theory that the services required and rendered under the contract by petitioner's employees other than Gillam were merely incidental to the services required and performed by Gillam. That conclusion resulted in the finding that slightly more than 80% of petitioner's gross income (including the $24,000.00 received under the United contract) was personal holding company income making petitioner a personal holding company under Section 402 of the Revenue Act of 1938 subject to the penalty surtax rates applied

against such companies and a penalty for failing to file a personal holding company return.

The majority opinion of the Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals. Honorable Judge Minton in his dissenting opinion stated:

> "In the contract that produced the considerations the Government would tax, the petitioner contracted for and rendered budgetary, accounting and income tax services that Gillam was wholly incapable of performing, and some of which, such as the making of income and other tax reports, could not have been of the slightest assistance to Gillam in the performance of his services. Indeed, of the services rendered by the petitioner to earn the $24,000 income involved in this case, $16,000 was for services rendered by petitioner's staff other than Gillam. I cannot agree that these services were incidental, and on a par with those of a craftsman's helper who 'fetched and carried' tools and materials for the craftsman to perform his job. These large and valuable services, which Gillam did not and could not perform, were not rendered just in apprenticeship or as assistance to Gillam in the performance of his duties. The services were independent services rendered by the petitioner. Gillam did not render all of the services paid for. He did not render over a third of the total services performed by the petitioner."

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the budgetary and accounting services rendered under the United contract were merely incidental to the services rendered by Gillam and that the contract was therefore a personal service contract under Section 403(e) of the Revenue Act of 1938.

(2) In holding that the personal service contract section (Section 403(e) of the Revenue Act of 1938) included

a contract requiring services which were not and could not be performed by the individual designated in the contract.

(3) In holding that petitioner was a personal holding company under Section 402 of the Revenue Act of 1938.

(4) In affirming the decision of the Board of Tax Appeals.

Reasons for Granting the Writ.

(1) In the present case the Circuit Court of Appeals for the Seventh Circuit has so construed Section 403(e) of the Revenue Act of 1938, which is presently incorporated in Section 502(e) of the Internal Revenue Code, so as to subject to the severe personal holding company surtaxes legitimate personal service corporations which were never intended to be so subjected by Congress.

Section 403(e) was adopted by Congress to prevent instances—

> "where an individual with unique talents, whose compensation for personal services was large, formed a corporation which contracted with him for his services at a relatively modest figure, and then contracted out his services with third persons at a much higher figure. The corporation accumulated the difference between the sums received and the sums paid to the individual, and under existing law paid only the corporate normal and undistributed-profits taxes thereon * * *." (House Ways and Means Committee Report on Section 403 of the Revenue Act of 1937, 1939-1 (Part 2) C. B. p. 707.)

The Committee Report continues:

> "The provision that some third party must have the right to designate *who* shall perform *the* services contracted for, or that *the* person to perform *the* services must be designated in the contract, will prevent this rule from applying in general to operating corporations engaged primarily in rendering personal services and which necessarily enter contracts to

render such services, selecting such members of their staff as they desire to render such services." (Italics supplied.)

This Court should now decide whether legitimate personal service corporations, such as accounting, architectural or advertising concerns, are subject to the confiscatory personal holding company surtaxes in the event clients of such corporations rely upon principal officers of the corporations and insist upon their final judgment even though a greater portion of the services required by contracts cannot be performed by the principal officer and are actually performed by other employees of the corporation who are so designated by the corporation and not by the client. The costs of such services by others may consume more than 50% of the compensation received or as high as 66⅔% of such compensation, as is the case in the cause here presented.

In all fairness to such legitimate personal service companies, they should now be informed as to their tax liability and this Court should now decide whether 90% or more of their total net income may be consumed in the payment of taxes and penalties. In the instant case in excess of 92% of petitioner's 1938 net income has been so consumed under the decision of the Circuit Court of Appeals.

This Court has recently recognized the advisability of passing upon the propriety under the personal holding company sections of the law of imposing penalties for failure to file personal holding company returns. In the case of *R. Simpson & Co., Inc., petitioner* v. *Guy T. Helvering, Commissioner of Internal Revenue, respondent*, 128 F. (2nd) 742, this Court on June 7, 1943 granted a writ of certiorari to review that question.

(2) The Circuit Court of Appeals in its decision legislates so as to change the clear language of Section 403(e). That section includes within its purview contracts under

which a corporation is to furnish personal service if the contract designates *the* individual *who* is to perform the services. The Section does not include a contract which designates an individual who is to perform only part of the services required under the contract. The Section reads:

> "(e) Personal Service Contracts—(1) amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) *the* individual *who* is to perform *the* services, or if *the* individual *who* is to perform *the* services is designated (by name or by description) in the contract; and (2) amounts received from the sale or other disposition of such a contract. This sub-section shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for *the* individual *who* has performed, is to perform, or may be designated (by name or by description) *as the one to perform,* such services." (26 U. S. C. A. p. 1130, Act 1938, Sec. 403.) (Italics supplied.)

In view of the penalty nature of the Act, this Court should now decide whether the Circuit Court of Appeals' construction is a proper one under the language of the law.

Conclusion.

For the foregoing reasons it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

CARL MEYER,
HARRY THOM,
BENJAMIN A. RAGIR,
Attorneys for the Petitioners.

Chicago, Illinois,
August, 1943.

APPENDIX.

Revenue Act of 1938, c. 289, 52 Stat. 447:

"SEC. 402. DEFINITION OF PERSONAL HOLDING COMPANY.

"(a) GENERAL RULE.—For the purposes of this title, and Title I, the term 'personal holding company' means any corporation if—

"(1) GROSS INCOME REQUIREMENT.—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 403; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

"(2) STOCK OWNERSHIP REQUIREMENT.—At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

* * * * *

"SEC. 403. PERSONAL HOLDING COMPANY INCOME.

"For the purposes of this title the term 'personal holding company income' means the portion of the gross income which consists of:

* * * * *

"(e) PERSONAL SERVICE CONTRACTS.—(1) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by

name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and (2) amounts received from the sale or other disposition of such a contract. This subsection shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services."

* * * * *

Regulations 101, Article 402-2:

"Gross income requirement.—To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year be personal holding company income as defined in section 403:

"(a) 80 per cent or more; or

"(b) 70 per cent or more if the corporation has been classified as a personal holding company for any taxable year beginning after December 31, 1936, unless—

"(1) a taxable year has intervened since the last taxable year for which it was so classified, during no part of the last half of which the stock ownership requirement specified in section 402(a)(2) exists; or

"(2) three consecutive years have intervened since the last taxable year for which it was so classified, during each of which its personal holding company income was less than 70 per cent of its gross income.

"In determining whether the personal holding company income is equal to the required percentage of the total gross income, the determination must not be made upon the basis of gross receipts, since gross income is not synonymous with gross receipts. For a

further discussion of what constitutes 'gross income', see section 22 (a) and the regulations prescribed under that section."

Regulations 101, Article 403-1:

"Personal holding company income.—The term 'personal holding company income' means the portion of the gross income which consists of the following:

* * * * *

"(8) Amounts received under personal service contracts.—Amounts includible in personal holding company income as amounts received under personal service contracts consist of amounts received persuant to a contract under which the corporation is to furnish personal services, and amounts received from a sale or other disposition of such a contract, if—

"(a) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

"(b) at some time during the taxable year 25 per cent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description), as the one to perform such services. For this purpose the stock ownership must be determined as provided in section 404 and articles 404(a)-1 to 404(a)-7, article 404(b)-1 and the last paragraph of article 402-3.

"The application of section 403(a) may be illustrated by the following examples:

"Example (1): A, whose profession is that of an actor, owns all of the outstanding capital stock of the M Corporation. The M Corporation entered into a contract with A under which A was to perform personal services for the person or persons whom the

M Corporation might designate, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation entered into a contract with the O Corporation in which A was designated to perform personal services for the O Corporation in consideration of which the O Corporation was to pay the M Corporation $500,000 a year. The $500,000 received by the M Corporation from the O Corporation constitutes personal holding company income.

"Example (2): The N Corporation, the entire outstanding capital stock of which is owned by four individuals, is engaged in engineering. The N Corporation entered into a contract with the O Corporation to perform engineering services for the O Corporation, in consideration of which the O Corporation was to pay the N Corporation $50,000. The individual who was to perform the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $50,000 received by the N Corporation from the O Corporation does not constitute personal holding company income."

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 248

GENERAL MANAGEMENT CORPORATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 129–144) is reported in 46 B. T. A. 738. The opinion of the Circuit Court of Appeals (R. 158–162) is reported in 135 F. 2d 882.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 24, 1943. (R. 163.) A petition for a rehearing was filed by the taxpayer on June 8, 1943, and was denied by the Circuit Court of Appeals on July 6, 1943. (R. 165, 173.) The

petition for a writ of certiorari was filed on August 9, 1943. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question is whether the taxpayer was taxable as a personal holding company under Section 401 of the Revenue Act of 1938. The answer depends on whether income derived from a contract under which the taxpayer agreed to furnish personal services constituted "personal holding company income" under Section 403 (e) (1) of the Act. This depends in turn on whether the contract designated "the individual who is to perform the services" within the meaning of that section.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The taxpayer, an Illinois corporation, was formed in 1929 for the purpose of financially rehabilitating businesses the credit of which had become impaired, rendering budgetary and accounting services and general corporate financial planning. (R. 129–130.) During 1938, the year in question, the 200 outstanding shares of the corporation were owned by Grant Gillam, 100 shares, S. Margaret Gillam, his sister, 80 shares, and Marguerite Miller, 20 shares. (R. 130.)

Gillam had had wide experience in corporate management and production. Prior to the formation of the taxpayer, he had acted as sales manager of a truck manufacturing company and later became president of the company. Certain banks which were creditors of corporations unable to liquidate loans found that Gillam was successful in arranging repayment of such loans. His services while he was still an employee of the truck company were loaned to other corporations which were indebted to the banks. Gillam was equally successful in liquidating these debts. After solving the financial and management problems of several corporations and in the belief that business could be obtained on the basis of his reputation and experience, Gillam caused the taxpayer to be formed. (R. 130.)

The taxpayer first became active in 1932 and in that year acquired offices in Chicago, Illinois. Gillam immediately made contact with the persons with whom he had done business previously, attempting to obtain for the taxpayer the type of business at which he and his associates had been successful, such as surveys of businesses, accounting reports, monthly analyses, and preparation of budgets. At this time the taxpayer's staff consisted of Gillam, Miller, and A. K. Taber. Miller is an experienced accountant skilled in the preparation of budget projects and had been in charge of the accounting department of the truck corporation of which Gillam had been president. Taber was a qualified cost accountant. (R. 130.)

During the year 1932 the taxpayer made surveys of businesses primarily for the Continental Illinois Bank & Trust Company. In April or May, 1932, the taxpayer, at the request of a bankers' committee representing seven banks, began a preliminary survey of the business and property of United Printers & Publishers, Inc. The bankers' committee instructed the taxpayer to inspect the operating divisions of United with the view of determining whether unsecured debts in the sum of $1,375,000 owed to the banks by United might be reduced 25%. The taxpayer prepared a survey for the banks, made upon the verbal assurance of the bankers' committee that if the survey showed that the business of United might be continued the banks would recommend that taxpayer be placed in charge of handling their interests in United. (R. 130–131.)

In making the survey, Gillam visited all the operating divisions of the company and gathered information concerning possible increase of efficiency in operation, the reduction of expenses, and the amount of capital necessary for the year's operation. Gillam examined the plant and production system of United and made suggestions for more efficient operation. The investigation also showed the necessity of revising United's cost system. From this information Miller, with the assistance of an auditor, prepared the taxpayer's report to the banks. The taxpayer's sur-

vey of United included the projection of the entire year's operations upon a monthly basis. The banks agreed to follow the plans suggested in the taxpayer's survey and taxpayer thereafter made monthly statements of United's business which were compared with the monthly budget submitted in the survey. In addition to the survey of United, the taxpayer made several other surveys in 1932 and submitted accounting reports for other clients. During 1932 the taxpayer had no contract with United. Through 1933 and 1934 the taxpayer continued to supply similar services to United and the banks. (R. 131.)

In 1935 the taxpayer, United and the bank creditors entered into a contract under which United agreed to reduce its outstanding debentures and debts to the banks. Under the contract, United agreed that until the banks were paid in full, it would retain the taxpayer in the same capacity as before, "it being further understood that General Management Corporation will continue to supply to the Company the services of Grant Gillam as Comptroller." For these services "including the services of said Grant Gillam, as Comptroller" the taxpayer would be paid $2,500 per month. It was further provided that if (R. 133)—

> Gillam shall die or shall become incapacitated to such an extent as to make it impossible for him to continue as Comp-

> troller of the Company and General Management Corporation is within three months thereafter unable to supply an individual for Comptroller who is acceptable to the bank Creditors and to the Company, the agreement with General Management Corporation may, at the option of the Company, be terminated when a new Comptroller acceptable to the Bank Creditors has been elected.

The contract in issue here was executed in February 1937. At that time the bank loans were retired, and the taxpayer made its own arrangement with United. By this contract United employed the taxpayer "for services to be rendered by it, as hereinafter more specifically defined (including the services of said Grant Gillam as Comptroller), at the sum of $2,000.00 per month, payable semi-monthly." (R. 134.) The contract then provided as follows (R. 134–135):

> It is understood and agreed that the Company will continue to furnish from data supplied to it by the Corporation or its various divisions, monthly and annual statements, make up yearly budgets projecting the Corporation's operations, use its best efforts to negotiate such loans, as the Corporation may from time to time require in the regular conduct of its business, check all requisitions and study in detail the Corporation's various operating, management and sales problems, and submit such suggestions as it may have for reduc-

ing operating cost and improving the Corporation's profit and financial position The Company will have general supervision over the Corporation's operations to the extent that the Corporation agrees to give the Company full cooperation and to follow recommendations made by the Company promptly and to give them a fair trial. Grant Gillam, as Comptroller, shall continue to supervise the fiscal operations of the Corporation, its divisions and its subsidiaries, and no monies shall be borrowed by the Corporation, its divisions and its subsidiaries, and no payments shall be made to any of the Creditors of the Corporation, its divisions and its subsidiaries without the approval of such Comptroller. The counter signature of such Comptroller or some person or persons designated by him, shall be required on all checks, notes or obligations for the payment of money made or issued by the Corporation, its divisions or any of its subsidiaries. The Corporation, however, reserves the right to pay its entire bank indebtedness at any time.

In the event that the said Grant Gillam shall die or shall become incapacitated to such extent as to make it impossible for him to continue as Comptroller of the Corporation and the Company is within three months thereafter unable to supply an individual for Comptroller who is acceptable to the Corporation, this agreement may, at the option of the Corporation, be terminated.

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The services which the taxpayer performed for United during the year 1938 under this contract were of two types, accounting and financial. The accounting services included a budget projection, analysis of monthly reports received from bookkeepers in the two operating divisions of United, and the consolidation of those figures into monthly reports submitted to it, as well as the preparation of income and miscellaneous tax reports. The financial services consisted of a budget of United's cash requirements for the forthcoming year and the arranging for working capital during the seasonal production period. The taxpayer arranged for all of United's loans and handled the cash receipts and disbursements of that corporation, including the payment of all the bank loans. Copies of the budget prepared by the taxpayer's organization were given to department heads of United for purposes of guidance. (R. 135–136.)

The taxpayer controlled the cash of United. All funds were kept in one account from which nothing could be drawn except over the signature of Gillam, Taber (another employee of the taxpayer), or Miller. No audits of United were made except by taxpayer. The taxpayer's audit reports were accepted by the banks which loaned United money. (R. 136.)

In 1938 the taxpayer maintained a staff of eight individuals, including Gillam, Taber, and Miller.

During 1938 the employees of the taxpayer other than Gillam devoted approximately 75% of their time to the services performed for United. Gillam devoted between 25% and 40% of his time to United in 1938. About 75% of the taxpayer's overhead expenses, or $16,000, was allocated to the services rendered United in 1938. In the year 1938 the taxpayer paid salaries other than to officers in the sum of $6,562. In 1938 Gillam was president of the taxpayer and received a salary of $25,000, Miller was secretary-treasurer of the taxpayer and received a salary of $3,600, and Earl Lowe, vice president of the taxpayer, received a salary of $2,358.94. (R. 136.)

The taxpayer's gross income for the year 1938 consisted of the following (R. 139):

Amounts received or due under United contract dated February 11, 1937	$24,000.00
Amounts received under Magill contract dated June 25, 1934	10,398.42
Amounts received from Consolidated Biscuit Co. as directors' fees	450.00
Interest received	1,091.57
Capital gains on shares of stock	14,931.00
Dividends	6,223.00
Amounts received on final liquidation of Chicago Armored Car Co	3,745.44
Total	$60,839.43

On its income and excess profits tax return for the year 1938, taxpayer reported gross income in the amount of $48,162.31. (R. 139.)

The Board of Tax Appeals held that the amount received by the taxpayer under the United con-

tract constituted personal holding company income derived from a personal service contract as defined by Section 403 (e) (1) of the Revenue Act of 1938. (R. 142.) The inclusion of this amount resulted in a finding that more than 80% of the taxpayer's gross income in 1938 was personal holding company income thereby constituting the taxpayer a personal holding company within the terms of Section 402 and subject to the surtax imposed by Section 401 of the Revenue Act of 1938, and that the taxpayer was liable for the penalty imposed for failure to file a personal holding company return for 1938. (R. 144.) The Circuit Court of Appeals affirmed. (R. 163.)

ARGUMENT

Section 403 (e) (1) includes within the definition of "personal holding company income" amounts received under a contract under which a corporation is to furnish personal services "if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract." That individual must be a holder of over 25% of the corporation's stock. The contract here, by which the taxpayer undertook to furnish the various financial and accounting services specified, expressly provided that Gillam, its

principal stockholder, continue as comptroller to "supervise the fiscal operations of the Corporation, its divisions and its subsidiaries." (R. 134.) If Gillam was unable to continue as comptroller, United retained the option to terminate the agreement.

The Board of Tax Appeals concluded that while the contract provided that the taxpayer furnish monthly statements, prepare budgets, and submit suggestions for improvements of United's profit and financial position, Gillam's individual services were the important ones and that it was for these services that United was entering into the contract. (R. 141–142.) The Circuit Court of Appeals, after pointing out the essentially mechanical character of the taxpayer's functions as compared with Gillam's supervisory duties, concluded that the Board was clearly justified in finding from the evidence that (R. 160–161)—

> discretionary service designated to be performed by Gillam was the inspiring motive for his designation and that the makers of the tools utilized supplied only incidental aid necessary to achievement of the desired purpose,—administrative supervision by Gillam.

Obviously the statute should not be limited in its application to cases where the contracts designate one person to perform himself every item of service contemplated. Both the Board of Tax

Appeals and the court below approached the question as one of determining whether it was the services of the person designated for which United was principally contracting. That is not only a reasonable basis for the application of the statute but any narrower construction might well make the provision ineffectual. Upon this test, there is plainly no ground for questioning the correctness of the conclusion reached on the facts involved.

There is no conflict. There is likewise no occasion for review of the decision because of its possible bearing upon contracts entered into by other personal service corporations. (Pet. 7.) The application of the statute to such companies will depend upon the peculiar facts of each case.

R. Simpson Co. v. *Helvering,* 128 F. 2d 742 (C. C. A. 2d), certiorari granted, June 7, 1943, No. 1, this Term, presents the question whether the penalty provisions of the statute are applicable where a corporation files an ordinary corporate return but not a personal holding company return. See also the Government's petition for certiorari in *Lane-Wells Co.* v. *Commissioner,* 134 F. 2d 977 (C. C. A. 9th), No. 115, October Term, 1943. While the taxpayer here has referred to the *Simpson* case in its Reasons for Granting the Writ (p. 7), it did not challenge the propriety of the penalty (if it is otherwise subject to the tax) either before the Board of Tax Ap-

peals, before the court below, or in the specification of errors in its petition for certiorari.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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AUGUST 1943.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 401. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year, upon the undistributed Title IA net income of every personal holding company (in addition to the taxes imposed by Title I) a surtax equal to the sum of the following:

(1) 65 per centum of the amount thereof not in excess of $2,000; plus

(2) 75 per centum of the amount thereof in excess of $2,000.

SEC. 402. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General Rule.*—For the purposes of this title, and Title I, the term "personal holding company" means any corporation if—

(1) *Gross Income Requirement.*—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 403; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

(2) *Stock Ownership Requirement.*—At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

* * * * *

SEC. 403. PERSONAL HOLDING COMPANY INCOME.

For the purposes of this title the term "personal holding company income" means the portion of the gross income which consists of:

* * * * *

(e) *Personal Service Contracts.*—(1) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and (2) amounts received from the sale or other disposition of such a contract. This subsection shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

* * * * *

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

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ART. 403–1. *Personal holding company income.*—The term "personal holding company income" means the portion of the gross income which consists of the following:

* * * * *

(8) *Amounts received under personal service contracts.*—Amounts includible in personal holding company income as amounts received under personal service contracts consist of amounts received pursuant to a contract under which the corporation is to furnish personal services, and amounts received from a sale or other disposition of such a contract, if—

(*a*) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(*b*) at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description), as the one to perform such services. For this purpose the stock ownership must be determined as provided in section 404 and articles 404 (a)–1 to 404 (a)–7, article 404 (b)–1 and the last paragraph of article 402–3. The application of section 403 (a) may be illustrated by the following examples:

Example (*1*): A, whose profession is that of an actor, owns all of the outstanding capital stock of the M Corporation. The M Corporation entered into a contract with

A under which A was to perform personal services for the person or persons whom the M Corporation might designate, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation entered into a contract with the O Corporation in which A was designated to perform personal services for the O Corporation in consideration of which the O Corporation was to pay the M Corporation $500,000 a year. The $500,000 received by the M Corporation from the O Corporation constitutes personal holding company income.

Example (2): The N Corporation, the entire outstanding capital stock of which is owned by four individuals, is engaged in engineering. The N Corporation entered into a contract with the O Corporation to perform engineering services for the O Corporation, in consideration of which the O Corporation was to pay the N Corporation $50,000. The individual who was to perform the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $50,000 received by the N Corporation from the O Corporation does not constitute personal personal holding company income.

U. S. GOVERNMENT PRINTING OFFICE: 1945